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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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WASHINGTON, D.C. 20554

In the Matter of)
Federal-State Joint Board on) CC Docket No. 96-45
Universal Service)

TO: The Commission

PETITION FOR RECONSIDERATION

The Western Alliance, pursuant to 47 U.S.C. §405 and 47 C.F.R. §1.429, petitions for reconsideration of the Commission's order in Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Order On Reconsideration, FCC 97-157 (released July 10, 1997) [summarized at 62 FR 40742 (July 30, 1997)] ("USF Reconsideration Order").

The Western Alliance

The Western Alliance has commented upon the Commission's Notice of Proposed Rulemaking¹ and the Joint Board's Recommended Decision² in this docket, and has petitioned for reconsideration of the Commission's Report And Order.³ It is a consortium of the Western Rural Telephone Association (WRTA) and the Rocky Mountain

¹ Federal State Joint Board on Universal Service, CC Docket No. 96-45, Notice of Proposed Rulemaking and Order Establishing a Joint Board, FCC 96-93 (rel. Mar. 8, 1996) ["USF NPRM"]..

² Federal State Joint Board on Universal Service, CC Docket No. 96-45, Recommended Decision, 12 FCC Rcd 87 (1996)

³ Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report and Order, FCC 97-157 (released May 8, 1997) (summarized at 62 FR 32862 (June 17, 1997)) ["USF Order"].

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Telecommunications Association (RMTA). These two associations represent nearly 250 small local exchange telephone carriers (LECs) serving rural areas west of the Mississippi River, including Alaska, Hawaii and insular territories.

**The Corporate Operations Expense Limitation
Slashes Universal Service Support For Rural LECS**

On June 3, 1997, Chairman Hundt told the Senate Subcommittee on Communications that the USF Order was "welcome news" for the small LECs which comprise "the backbone of telephone service in rural America."⁴ He declared:

[W]e did not lower the current level of universal service support provided to small LECs. They will not lose the amounts they currently receive from DEM weighting, long term support or from the existing high cost fund, and universal service support will continue to grow to reflect new investment. Id.

Unfortunately, the support presently provided to many rural LECs by the existing high cost fund will be drastically and precipitously cut during the Commission's "transition" period. One provision alone will reduce the existing support of many rural LECs by hundreds of thousands of dollars -- namely, the cap imposed in the USF Order (and revised in the USF Reconsideration Order) on the amount of Corporate Operations Expense (Accounts 6710 and 6720) that carriers can recover from high cost support mechanisms. This cap will impact most adversely small, rural LECs having the least ability to cope with major revenue fluctuations.

⁴ Statement of Reed E. Hundt on the FCC's Plan for Implementing Universal Service, before the Subcommittee on Communications, Committee on Commerce, Science and Transportation (June 3, 1997) at 3.

Corporate Operations Expense constitutes a critical and substantial portion of a LEC's largely fixed, general expenses, including compensation for officers, directors, general managers and clerical staff; compensation and fees for auditors, tax accountants, staff accountants, bookkeepers, and cost consultants; expenses for banking and cash management services; expenses for applications, tariffs and other filings with the Commission and state/local regulatory authorities; expenses for employee benefit, training, safety and activity programs (including administration of Equal Employment Opportunity and Affirmative Action programs); expenses for development and administration of data bases; expenses and fees for FCC, state regulatory, and local counsel; expenses for procuring materials and supplies; expenses for business planning, and research and development activities; and payments and insurance premiums for losses, accidents, sickness, disability and death benefits. Copies of the Part 32 description of Accounts 6710 and 6720, as well as a list of the expenses included therein, are attached as Exhibits A and B hereto.

The formulas adopted by the Commission in Section 36.621(a)(4) of its Rules cap the amount of support recoverable for Corporate Operations Expenses at unreasonably low levels. For example, the caps for illustrative small LECs are as follows:

<u>Number of Working Loops</u>	<u>Capped Corporate Operations Expense</u>
1,000	\$ 28,888.00
2,000	53,176.00
3,000	72,864.00
4,000	87,952.00
5,000	98,440.00
6,000	104,328.00
7,000	107,943.60
8,000	111,531.60
9,000	115,119.60
10,000	118,707.60
11,000	122,295.60

In recognition that at least some "portion" of Corporate Operations Expense is fixed, the Commission established a minimum cap of \$9,505.90 for all LECs.

These capped amounts are unrealistically low. Granted that pay scales are somewhat lower in Rural America than in the District of Columbia, the Western Alliance nevertheless knows of precious few places where as much as a single, inexperienced clerical employee can be hired for \$9,505.90, or even \$28,888.00, in salary and benefits. Even in the more depressed, low-wage rural areas, the minimum compensation needed for a LEC to obtain and retain a competent telephone manager and a small accounting/bookkeeping/clerical staff significantly exceeds the foregoing capped amounts.

Put simply, the foregoing Corporate Operations Expense caps do not recover even the minimal expense of a low-paid, bare-bones administrative staff for most rural LECs. These caps wholly and immediately eliminate long-established support for essential executive, accounting, finance, regulatory, human resources, legal, procurement, insurance and planning expenses incurred by rural LECs.

The Commission's modified cap formula reduces existing USF

support for over 70 rural LECs by more than \$100,000 per year, and for over 30 rural LECs by between \$50,000 and \$100,000 per year. Like the original cap, the adverse impact of the modified cap falls mainly upon small, rural LECs (particularly those having 10,000 or fewer loops) that can least afford sudden, large revenue decreases.

The Commission's elimination of recovery of most Corporate Operations Expense from transitional high cost support violates the core Congressional principle that universal service support mechanisms be sufficient. 47 U.S.C. §254(b)(5). By unexpectedly cutting high cost support revenues for many rural LECs during a transition period erroneously characterized as maintaining current support levels, the Commission is taking away from rural LECs tens and hundreds of thousands of dollars critically needed to construct and maintain the infrastructure necessary to provide rural areas with telecommunications services and rates comparable to those in urban areas. 47 U.S.C. § 254(b)(3).

The Western Alliance also notes that the Commission's cap on Corporate Operations Expense was not proposed in its USF NPRM herein, but rather is a vestige of the Commission's Notice of Proposed Rulemaking in CC Docket No. 80-286.⁵ This constitutes a direct violation of the intent of Congress, which expressly noted that it did not view the proceedings under CC Docket No. 80-286 "as an appropriate foundation on which to base the proceedings required

⁵ Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, Notice of Proposed Rule Making and Notice of Inquiry, 10 FCC Rcd 12309 (1995).

by new Section 254(a)." Joint Explanatory Statement of the Committee of the Conference (H.R. Rep. No. 458, 104th Cong., 2d Sess.) at 131.

Corporate Operations Expenses Are Not Discretionary

Corporate Operations Expense has long been deemed a cost inherent in providing local exchange and exchange access services, and has been supported through the existing federal Universal Service Fund (USF) pursuant to the recommendation of the Federal-State Joint Board.⁶ Neither the USF Order nor the USF Reconsideration Order offer any explanation why federal support should now be withdrawn, much less precipitously eliminated. Rather, the Commission has noted merely that these expenses "do not appear to be costs inherent in providing telecommunications services, but rather may result from managerial priorities and discretionary spending." USF Order at para. 283.

The various elements of Accounts 6710 and 6720 are not "discretionary," but rather constitute essential elements of administering any functional business or organization. Clearly, the Commission has not yet informed Congress that the various management, accounting, financial management, human resources, procurement, legal, planning, security and insurance expenses in

⁶ Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 80-286, Recommended Decision And Order, 5 FCC Rcd 7578, 7579 (1990); Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 80-286, Report And Order, 6 FCC Rcd 2936 (1991).

its budget are "discretionary" and capable of elimination without adverse consequences.

The only element of Corporate Operations Expense that arguably can be classified as "discretionary" is the regulatory and regulatory compliance expense element [Account 6722(a) and (b)]. Yet, virtually all of the "discretion" regarding regulatory expenses lies with the Commission and the state utility commissions which initiate and impose regulatory and licensing requirements, and not with the rural LECs which must respond and comply with them. At the federal level alone, the Commission has conducted a myriad of complex proceedings during recent years regarding local competition, collocation, access pricing, universal service, dialing parity, number administration, caller ID, wireless service and other critical matters, and has issued numerous and lengthy notices, orders and regulations therein. Many rural LECs have been forced to spend tens of thousands of dollars each year simply to monitor, analyze and comply with these Commission requirements. Limitation of the recovery of such expenses will not only disenfranchise rural LECs from participation in critical Commission and state proceedings which directly affect their businesses, but also will preclude or hamper their compliance with federal and state regulatory changes.

**The Commission's Cap Formula Demonstrates
The Futility And Harmful Impact Of Proxy Models For Small LECs**

The facilities and cost structures of rural LECs did not develop according to a common Bell System or other large LEC model.

Rather, they evolved separately and independently as responses by different managements at different times to the unique conditions of different geographic, technical and customer environments. Because of their widely varying circumstances, there is no manageable (much less, single) variable or set of variables which can accurately and equitably determine "reasonable" Corporate Operations Expense or any other cost for rural LECs.

Figure 1 of the USF Reconsideration Order demonstrates the futility and unfairness of Commission attempts to impose proxy models like regression formulas upon rural LECs. Whereas the data for LECs with more than 15,000 loops appear to fit the Commission's regression line relatively closely, the data for LECs with fewer than 15,000 loops (and particularly for LECs with fewer than 5,000 loops) are widely scattered about the line. This means that many rural LECs will be "losers" in that their federal high cost support will be reduced by the Commission's cap to a level far below that necessary to recover their actual Corporate Operations Expenses. At the same time, the Commission's regression line (which is based upon a single variable and a single year of NECA data) offers no indication whether the expenses excluded from recovery by particular LECs were reasonable, necessary and/or required by federal or state regulation. Put another way, the location of a particular rural LEC's data point above or below the Commission's Figure 1 regression line is a function of that LEC's own specific history and environment, and indicates nothing whatsoever regarding the "reasonableness" of the LEC's administrative expenses. The use

of such an irrelevant formula or regression model to cut the Universal Service support of many rural LECs during the "transition" period is wholly inimical to the "specific, predictable and sufficient" principle of new Section 254(b)(5) of the Communications Act.

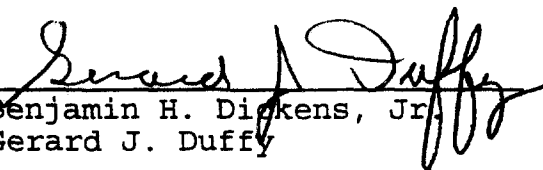
Conclusion

The Commission's cap on recovery of Corporate Operations Expense, both in its original form and as modified in the USF Reconsideration Order, will immediately and unreasonably slash the existing high cost support for many rural LECs by hundreds of thousands of dollars during the Commission's allegedly stable "transition" period. The caps set by the Commission's formula wholly fail to reflect the reasonable and necessary managerial and administrative expenses of rural LECs, and are particularly insensitive to the legal and consulting expenses currently required to keep abreast of the numerous and complex federal and state regulatory proceedings affecting rural LECs. Neither the Commission nor any other party has explained why these expenses are "discretionary" rather than essential, or why they should not continue to be supported by the federal high cost mechanism. Finally, the Commission's regression-based formula graphically demonstrates why proxy models are not appropriate for rural LECs.

Imposition of the initial or modified cap will deprive many rural LECs of revenues essential for the development and maintenance of the telecommunications infrastructure and affordable

services upon which rural communities depend. The Commission is respectfully requested to reconsider and eliminate the Section 36.621(a)(4) formulas and caps, and to continue to permit recovery of actual Corporate Operations Expense through the federal high cost mechanism, except in those rare instances where specific expenses claimed by a particular LEC are demonstrated to be unnecessary and unreasonable.

Respectfully submitted,
THE WESTERN ALLIANCE

By 
Benjamin H. Dickens, Jr.
Gerard J. Duffy

Its Attorneys

Blooston, Mordkofsky, Jackson &
Dickens
2120 L Street, N.W., Suite 300
Washington, D.C. 20037
(202) 659-0830

DATED: August 29, 1997

EXHIBIT A

SUBPART E - INSTRUCTIONS FOR EXPENSE ACCOUNTS

§32.5099 General. - (a) Structure of the expense accounts. - (1) The expense section of the system of accounts shall be organized by expense group summary account, account, and subsidiary record category (if required).

(2) The expense section of this system of accounts shall be comprised of four major expense groups -- Plant Specific Operations, Plant Nonspecific Operations, Customer Operations and Corporate Operations. Expenses to be recorded in Plant Specific and Plant Nonspecific Operations Expense Groups generally reflect cost associated with the various kinds of equipment identified in the plant asset accounts. Expenses to be recorded in the Customer Operations and Corporate Operations accounts reflect the costs of, or are associated with, functions performed by people, irrespective of the organization in which any particular function is performed.

(3) Summary accounts within expense groups shall be used to describe aggregations of two or more accounts having a certain commonality. Summary accounts are assigned numbers so that they may be used by Class A telephone companies to aggregate accounts for reporting purposes; and as specifically directed, so that they may be used as accounts by Class B telephone companies.

(4) Accounts shall be maintained as prescribed in this section subject to the conditions described in §32.13 in Subpart B. Subsidiary record categories may be required below the account level by this system of accounts or by Commission order.

(e) Corporate operations expense. - The corporate operations expense accounts shall include the costs of performing executive and planning activities and general and administrative activities described in narratives for individual accounts. These costs shall also include the costs of supervision, office support and training for these activities.

\$32.6710 Executive and planning. - This account number shall be used by Class A telephone companies to summarize for reporting purposes the contents of Accounts 6711 and 6712. Class B telephone companies shall use this account for expenses of the type and character required of Class A companies in Accounts 6711 and 6712.

\$32.6711 Executive. - This account shall include costs incurred in formulating corporate policy and in providing overall administration and management. Included are the pay, fees and expenses of boards of directors or similar policy boards and all board-designated officers of the company and their office staffs, e.g., secretaries and staff assistants.

\$32.6712 Planning. - This account shall include costs incurred in developing and evaluating long-term courses of action for the future operations of the company. This includes performing corporate organization and integrated long-range planning, including management studies, options and contingency plans, and economic strategic analysis.

\$32.6720 General and administrative. - This account number shall be used by Class A telephone companies to summarize for reporting purposes the contents of Accounts 6721 through 6728. Class B telephone companies shall use this account for expenses of the type and character required of Class A companies in Accounts 6721 through 6728.

\$32.6721 Accounting and finance. - This account shall include costs incurred in providing accounting and financial services. Accounting services include payroll and disbursements, property accounting, capital recovery, regulatory accounting (revenue requirements, separations, settlements and corollary cost accounting), non-customer billing, tax accounting, internal and external auditing, capital and operating budget analysis and control, and general accounting (accounting principles and procedures and journals, ledgers, and financial reports). Financial services include banking operations, cash management, benefit investment fund management (including actuarial services), securities management, debt trust administration, corporate financial planning and analysis, and internal cashier services.

\$32.6722 External relations. - This account shall include costs incurred in maintaining relations with government, regulators, other companies and the general public. This includes:

- (a) Reviewing existing or pending legislation (see also Account 7370, Special Charges, for lobbying expenses);
- (b) Preparing and presenting information for regulatory purposes, including tariff and service cost filings, and obtaining radio licenses and construction permits;
- (c) Performing public relations and non-product related corporate image advertising activities;
- (d) Administering relations, including negotiating contracts (see also Account 6725, Legal), with telecommunications companies and other utilities, businesses and industries. This excludes sales contracts (see also Account 6612, Sales); and
- (e) Administering investor relations.

\$32.6723 Human resources. - This account shall include costs incurred in performing personnel administration activities. This includes:

- (a) Equal Employment Opportunity and Affirmative Action Programs;
- (b) Employee data for forecasting, planning and reporting;
- (c) General employment services;
- (d) Occupational medical services;
- (e) Job analysis and salary programs;
- (f) Labor relations activities;
- (g) Personnel development and staffing services, including counseling, career planning, promotion and transfer programs;
- (h) Personnel policy development;
- (i) Employee communications;
- (j) Benefit administration;
- (k) Employee activity programs;
- (l) Employee safety programs; and
- (m) Non-technical training course development and presentation.

\$32.6724 Information management. - This account shall include costs incurred in planning, developing, testing, implementing and maintaining data bases and application systems for general purpose computers.

\$32.6725 Legal. - This account shall include costs incurred in providing legal services. This includes conducting and coordinating litigation, providing guidance on regulatory and labor matters, preparing, reviewing and filing patents and contracts and interpreting legislation. Also included are court costs, filing fees, and the costs of outside counsel, depositions, transcripts and witnesses.

\$32.6726 Procurement. - This account shall include costs incurred in procuring material and supplies, including office supplies. This includes analyzing and evaluating suppliers' products, selecting appropriate suppliers, negotiating supply contracts, placing purchase orders, expediting and controlling orders placed for material, developing standards for material purchased and administering vendor or user claims.

\$32.6727 Research and development. - (a) This account shall include costs incurred in making planned search or critical investigation aimed at discovery of new knowledge. It also includes translating research findings into a plan or design for a new product or process or for a significant improvement to an existing product or process, whether intended for sale or use.

(b) This excludes making routine alterations to existing products, processes, and other ongoing operations even though those alterations may represent improvements.

\$32.6728 Other general and administrative. - This account shall include costs incurred in performing general administrative activities not directly charged to the user, and not provided for in other accounts. This includes providing general reference libraries, food services (e.g., cafeterias, lunch rooms and vending facilities), archives, general security investigation services, operating official private branch exchanges in the conduct of the business, and telecommunications and mail services. Also included are payments in settlement of accident and damage claims, insurance premiums for protection against losses and damages, direct benefit payments to or on behalf of retired and separated employees, accident and sickness disability payments, supplemental payments to employees while in governmental service, death payments, and other miscellaneous costs of a corporate nature. This account excludes the cost of office services, which are to be included in the accounts appropriate for the activities supported.

EXHIBIT B

Corporate Operations Expense Limitation

The FCC proposes limiting the amount of Corporate Operations Expense that may be recovered through Universal Service Funding by claiming that Corporate Operations Expense is largely discretionary. To the contrary, much of Corporate Operations Expense is required by State and Federal regulation (indeed, regulation promulgated by the FCC itself).

Executive

- Formulating Corporate Policy
- Overall Administration & Management
- Board of Directors expenses

Planning

- Long-Range Planning
- Options and Contingency Plans
- Economic strategic analysis

Finance

- Financial accounting
- Regulatory accounting, including:
 - Revenue requirements
 - Jurisdictional separations
 - Settlements/access pool reporting
 - Associated cost accounting (cost of service, TELRIC, proxies)
- Payroll/disbursements
- Capital recovery
- Non-customer billing
- Audits (internal & external)
- Tax accounting and returns
- Continuing property records
- Financing
- Banking
- Cash management
- Benefit investment fund management (including actuarial services)
- Securities management
- Corporate financial planning and analysis
- Internal cashier services

External Relations

- Preparing & presenting information for regulatory purposes:
 - Access Tariffs
 - Cost of service filings
 - Earnings monitoring reports
 - Testimony, discovery, and hearings on regulatory matters
- Regulatory Compliance, including 1996 Telcom Act
- Intrastate Access Filings, Testimony, Discovery, Hearings
- Tariffs
 - New service offerings
 - Rate Proceedings
 - Special Contracts
- Obtaining FCC Radio Licenses
- Obtaining Construction permits
- Negotiating contracts
- Administering investor relations

Human Resources

- EEO and Affirmative Action Programs
- Maintaining employee records
- General employment services
- Occupational Medical Services

Job analysis and salary programs
Labor Relations activities
Personnel development/counseling
Personnel policy development
Benefit administration
Safety programs
Non-technical training

MIS

Data bases and applications systems for computers:
 Planning
 Development/programming
 Testing
 Implementing
 Maintaining

Legal

Conducting litigation
Guidance on regulatory and labor matters
Preparing contracts
Interpreting legislation
Court costs
Filing fees
Depositions
Transcripts

Procurement/Purchasing

Purchasing materials and supplies
Negotiating supply contracts
Placing purchase orders
Expediting and controlling orders
Administering vendor claims

Other General and Administration

Maintaining archives
Security services
Cost of telecommunications services
Mail services
Payment of accident and damage claims
Insurance premiums
Accident and disability claims